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BEFORE THE

Federal Communications Commission

WASHINGTON, D.C. 20554

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In the Matter of Adoption of a Uniform Accounting System for Provision of Regulated Cable Service	CS Docket No. 94-28

To: Chief, Cable Services Bureau

COMMENTS OF FALCON CABLE TV
IN RESPONSE TO
FURTHER NOTICE OF PROPOSED RULEMAKING

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SUMMARY

The Commission has not established a rational predicate for requiring a Uniform System of Accounts ("USOA") in conjunction with cost-of-service regulation. The telephone industry's USOA in Part 32 of the Commission's rules should not be a precedent because the circumstances are vastly different. Financial accounting according to Generally Accepted Accounting Principles ("GAAP") is perfectly adequate to enable the Commission to execute its Congressional mandate to ensure reasonable rates for basic services.

If the Commission concludes that a USOA is required, then it should conform that USOA much more closely with GAAP and recognize the inherent differences between the cable industry and the telephone industry. There is simply no justification for imposing on cable operators the significant expense of maintaining another set of books, records and accounting procedures.

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COMMENTS IN RESPONSE TO
FURTHER NOTICE OF PROPOSED RULEMAKING

Pursuant to 47 C.F.R. §§ 1.415, 1.421, Falcon Cable TV ("Falcon"),[1] by its attorneys, hereby files these comments on the Further Notice of Proposed Rulemaking portion[2] of the Commission's Cable Rate Regulation, Report and Order and Further Notice of Proposed Rulemaking, MM Docket No. 93-215 and CS Docket No. 94-28, FCC 94-36, 9 FCC Rcd ____ (rel. Mar. 30, 1994) ("Report and Order"). Falcon submits that the Commission need not prescribe a Uniform System of Accounts ("USOA") for cable operators in order to carry out its responsibilities under the

[1] Falcon is a Multiple System Operator ("MSO") operating systems in 27 states with more than 1 million subscribers.

[2] Uniform System of Accounts for Cable System Operators, 59 Fed. Reg. 10866 (Apr. 15, 1994) ("Further Notice").

1992 Cable Act.[3] If the Commission concludes that it must adopt a USOA similar to that proposed in Attachment C to its Report and Order, then the Commission should substantially change its USOA to reduce the expense and burden of compliance and to remove inconsistencies within the proposed USOA.

I. INTRODUCTION

In its Report and Order the Commission decided to adopt a uniform accounting system for cable operators that elect cost-of-service regulation. At the same time the Commission declined to adopt a USOA for operators that choose benchmark/price cap regulation on the ground that price regulation does not demand a cost-of-service foundation.[4] The Commission posited three reasons for adopting a USOA.

First, the Commission noted that accounting records "serve as the principle [sic] source of information for determining the reasonableness of rates" under cost-of-service regulation. Id., ¶ 219. Neither standard financial accounting according to Generally Accepted Accounting Principles ("GAAP") nor the interim

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[3] Cable Television Consumer Protection and Competition Act of 1992, 47 U.S.C. §§ 534, 535.

[4] The decision to adopt a USOA only for those operators choosing cost-of-service regulation itself presents a dilemma. The Commission's Report and Order, ¶ 29, seems to permit operators to elect cost-of-service but switch later to benchmarks, or vice versa. Hence, some operators would incur the expense and effort of instituting the USOA, only to abandon it later; others that do not implement the USOA at the outset may have greater difficulty doing so after two or more years of rate regulation have passed.

accounts adopted in the Report and Order, the Commission found, would be adequate in the long run for cost-of-service regulation purposes. The Commission expressed its concern that, absent a USOA, cable operators might not properly distinguish between capital investment and operating expense.[5] Id.

Second, the Commission found that a USOA would minimize variations in accounting practices among cable operators, thereby simplifying cost-of-service proceedings. Id., ¶ 220. Absent mandatory uniformity, the Commission said, accounting practices might vary widely, rendering cost-of-service regulation "less than ideally effective."[6] Id. The Commission observed that all

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[5] In the Report and Order, ¶ 219, n. 431, the Commission speculated that cable operators "could manipulate" their cost-of-service results, misclassify property and cross-subsidize unregulated services with regulated service revenues in the absence of a USOA. There is absolutely no justification for the Commission's suspicions at this juncture. The rates and practices of cable operators have not previously been regulated by the Commission. Cable operators are entitled to a presumption that they will obey the law and the Commission's regulations regardless of the Commission's experience with other firms or industries. In any event, neither the financial community nor the cable operators' auditors would condone any effort "to manipulate" financial practices or circumvent GAAP in either the financial books or in a separate set of regulatory books.

[6] The Commission cited in support of this proposition only the comments of BellSouth. BellSouth, one of the Regional Bell Operating Companies, has advanced positions throughout the cable regulatory proceedings that would handicap cable operators in their effort (a) to bring much-needed competition to the telephone industry, and (b) to have any flexibility in the provision of their cable services. Of course, BellSouth is a monopoly provider of telephone service and an aspiring entrant into the cable business. The Commission would be remiss in relying on the arguments and representations of large telephone companies for record support for its findings in these proceedings.

state and federal agencies that engage in cost-of-service regulation require uniform accounting practices. Third, the Commission found that the burden on cable companies of implementing and maintaining a USOA would be outweighed by the burden imposed on regulatory bodies charged with evaluating cost-of-service showings. Id., ¶ 221.

Based on these findings in the Report and Order, the Commission in Attachment C of the Further Notice proposed a USOA for cable operators that is identical in all major respects to 47 C.F.R. Part 32, Uniform System of Accounts for Telecommunications Companies. It contains 141 separate accounts accompanied by 41 single-spaced, letter-sized pages of instructions.

II. INSTEAD OF PRESCRIBING A USOA, THE COMMISSION SHOULD PERMIT CABLE OPERATORS TO RELY ON THEIR FINANCIAL ACCOUNTING RECORDS FOR COST-OF-SERVICE SHOWINGS

The Commission's rationale for prescribing a USOA is the subject of both petitions for reconsideration and judicial appeals of the Report and Order. Nevertheless, it is necessary here to examine the validity of the findings in the Report and Order because they ostensibly provide the factual and legal foundation for the USOA proposed in the Further Notice. If the Commission was wrong about the need for any uniform accounting in addition to GAAP, then it was certainly wrong in proposing a USOA adapted nearly word for word from Part 32 of the rules, which the Commission adopted to regulate the unified Bell Telephone System.

To begin with, the Commission cited no mandate from Congress to adopt a USOA, nor does it have one.[7] On the contrary, Congress explicitly told the Commission to avoid the types of burdens associated with the imposition of a USOA. The two directly relevant provisions of the Communications Act are Section 601(6) and Section 623(b)(2).

Section 601(6) states that one of the purposes of Title VI of the Communications Act is to "minimize unnecessary regulation that would impose an undue economic burden on cable systems." This was a provision of the Cable Communications Policy Act of 1984 ("1984 Cable Act") that Congress could have amended in the 1992 Cable Act but did not. On the contrary, Congress included in its 1992 amendments Section 623(b)(2)(A) which directs the Commission, in its regulation of basic service rates, to "seek to reduce the administrative burdens on subscribers, cable operators, franchising authorities, and the Commission." Thus, Congress, cognizant that the costs of regulation add to the costs of service, has at least twice told the Commission to be sensitive to the burdens imposed by its regulatory regime. As described below, the maintenance of a uniform system of accounts is one of the most oppressive of those burdens.

A key finding upon which the Commission relied to justify prescribing a USOA for cable operators is that government has

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[7] In Cable Rate Regulation, Notice of Proposed Rulemaking, MM Docket No. 93-215, 74 Rad. Reg. 2d 1247, ¶¶ 57-58 (1993), the Commission simply observed that it might be desirable to have a USOA.

always prescribed a USOA for regulated utilities. Further Notice, ¶¶ 219-20. While the general proposition that regulated telephone, gas and electric utilities have been required to maintain government-prescribed USOAs is true, the conclusion that cable operators must be regulated identically does not necessarily follow.

For one thing, in each of the circumstances cited by the Commission to support adoption of a USOA, Congress (or a state legislature in the case of state utility regulation) gave the regulatory agency explicit authority to adopt a USOA. For example, in the case of common carrier regulation, upon which precedent the Commission relies so heavily, Congress specifically included Section 220(a) in the original 1934 Act: "The Commission may, in its discretion, prescribe the forms of any and all accounts, records, and memoranda to be kept by carriers subject to this Act . . . ." Not only was there no comparable provision in either the 1984 or the 1992 Cable Act, but Section 621(c) gives instructions to the contrary: "Any cable system shall not be subject to regulation as a common carrier or utility by reason of providing any cable service." Congress's intent could hardly be clearer, yet the Commission proposes to engraft traditional public utility accounting requirements, by the Commission's own reckoning a fundamental instrument of public utility regulation, into its regulation of cable operators. It is neither lawful nor necessary.

In balancing the benefit of a USOA to support cost-of-service regulation against the cost and administrative burden of implementing it, the Commission concluded, with only superficial analysis, that the burden is outweighed by "the need for the most accurate information possible on the companies' cost of service." Further Notice, ¶ 221. In Falcon's view, the Commission has dealt much too cavalierly with cable operators' concerns about the burden.

Falcon submits that the burden is very consequential. Converting existing accounting systems, maintaining the USOA accounts and performing the associated cost allocations would at a minimum require three new professional staff for each accounting entity. There are thirteen accounting entities in the Falcon MSO, and 854 reporting areas, all of which could opt for cost-of-service regulation. Furthermore, Falcon would have to expand significantly its current computer capacity and most likely replace its existing hardware. The software and hardware are adequate for maintaining Falcon's financial accounting and tax books; therefore, the considerable expense would not otherwise be incurred. Additional burdens are discussed in Section III, below.

On the other side of the balance, the Commission is concerned about administrative burdens that might be imposed on it and local franchising authorities in the absence of a USOA. While this is, in general, a legitimate concern of regulators, Falcon does not believe that it need be one here. First, there

is no evidence that local franchising authorities cannot regulate rates based on financial accounting in accordance with Section 76.924 of the rules. Each franchising authority regulates only one cable operator, except in those few cases in which regulation will be done at the state level, or in which a single franchise area is served by two operators. The fact that a cable operator within a franchise area in, for example, Missouri, uses the same accounting method as a cable operator in Oregon, even if the two are part of the same MSO, is of no consequence to the franchising authority in Missouri. The franchising authority is concerned with the assets, revenues and expenses unique to its area. In other words, it should not matter at the local level whether cable operators use a regulatory USOA rather than financial accounting based on GAAP (which is itself a nationwide standard).

A USOA may even be counter-productive to efficient local rate regulation to the extent that systems of accounts based on traditional public utility regulation are significantly different from the financial or tax accounting systems with which franchising authorities, members of the public and cable operators themselves are more familiar. Thus, an accounting system prescribed by a federal agency, uniform or not, may impede rather than assist the execution of a local authority's regulatory responsibilities.

Second, it is not intuitively obvious that a USOA would actually provide administrative benefits for the Commission. The cable industry is far more heterogenous than the telephone

industry. Within the cable industry, organizational structures, service territories, cable plant infrastructures, and programming, among other things, vary dramatically from firm to firm. In contrast, some 98 percent of the telephone industry - the former Bell System, GTE and the other large independents such as Cincinnati Bell and SNET - is completely homogenous and has been for decades. Until very recently, all rates were averaged nationwide, all carriers had the same cost structure, all used the same types of outside plant and switching equipment, and all paid virtually the same wages for salaried and non-salaried workers. National standards were both sensible and easily implemented in an environment in which comparing one company or one area with another had value for the regulator and the public.

Third, the notion that a USOA would help make cost-of-service regulation "ideally effective," Report and Order, ¶ 220, or would necessarily guarantee "the most accurate information possible," Id., ¶ 221, is probably incorrect. It bears repeating that Congress mandated "reasonable" rates, not "ideal" rates or even the "most accurate" rates. The process of reaching reasonable rates is in no way dependent upon a prescribed, uniform accounting system used by every cable system.[8] It is

[8] The Commission also knows based on its extensive experience with the telephone industry that prescribing uniform accounting requirements does not eliminate controversy. The Commission is continuously altering and interpreting its Part 32 rules as changes in U.S. law, accounting industry standards and conventions, and telephone company business practices evolve. See, e.g., Petition for Rulemaking of Chouteau Tel. Co., et al., 5 FCC Rcd 2795 (1990) (method of accounting for computer software).

dependent upon the regulator's having reasonably accurate information about assets, revenues and costs. The burden remains on the cable operator to provide reliable information if it wants to receive approval of its rates. If the cost-of-service showing is not clear and persuasive, the cable operator does not receive higher rates.

Finally, in basing its proposed USOA on Part 32, even the portion that is applicable to the smaller, Class B telephone companies,[9] the Commission did not adequately account for the tremendous burden of implementing a new accounting system where there was none before. Telephone companies have had a USOA for more than 50 years. When it was first adopted (as Part 31 of the rules), the entire industry consisted of the Bell System or small, unaffiliated companies that depended on the Bell System for guidance and financial support. Changes to the USOA for telephone companies have been incremental and easily integrated into long-standing accounting systems originally designed for a single, huge, public utility providing telephone service nationwide.

In contrast, the Commission expects cable operators, who already maintain books for financial reporting and tax purposes, to establish a third accounting system that is in many respects

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[9] Class B companies are by no means small: they simply have a maximum of $100 million in annual regulated telecommunications revenues.

significantly different from the other two. It is predictable that entries will be miscoded as a matter of course. Because some of the USOA entries are inconsistent with GAAP (e.g., treatment of the charge to set up the allowance for bad debts), there will be confusion regarding accounting propriety. Cable operators will have to retrain staff (as well as hire new staff) to classify transactions in at least two ways based on the set of books. Moreover, the task of "mapping" existing financial accounts to a new set of regulatory accounts is no small task. The Commission allowed the telephone industry more than 18 months to convert the old Part 31 USOA to the new Part 32 USOA.[10] It should come as no surprise that the level of accuracy and compliance that the Commission expects will not be achieved easily or inexpensively.

III. IF THE COMMISSION DOES ADOPT THE PROPOSED USOA, IT MUST MAKE A NUMBER OF CHANGES

A. There Should Be No Exceptions to GAAP in the Initial USOA

First and foremost, the Commission should reduce or eliminate those accounting requirements that do not conform with GAAP. In lifting the proposed USOA from Part 32 the Commission has included the many instances in which traditional telephone

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[10] USOA Revision, 60 Rad. Reg. 2d (P&F) 1111, ¶ 107-08 (1986), reconsideration, 2 FCC Rcd 1086, 62 Rad. Reg. 2d (P&F) 434 (1987). The Commission issued its decision in May 1986, to be effective January 1, 1988. The United States Telephone Association estimated that it would cost the industry $1.1 billion to convert its existing USOA to the new USOA. 60 Rad. Reg. 2d at ¶ 9.

regulatory accounting does not follow GAAP. Section 76.1102(a), Records, states: "The reporting company's financial records shall be kept in accordance with generally accepted accounting principles to the extent permitted by this systems of accounts." Cable operators, along with all other unregulated public companies, keep all their accounts according to GAAP. See, also, 47 C.F.R. § 76.924. Only regulated utilities deviate from GAAP, as directed by regulators, to satisfy specific public interest goals of the local, state or federal government. It would seem better to initiate a new accounting system that assumes full compliance with GAAP and later to make exceptions to GAAP when, and as, necessary in the public interest. There is no basis for deciding as a threshold matter that the deviations from GAAP applicable to the telephone industry are equally applicable, not to mention relevant, to the cable industry.[11]

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[11] In 1985 the Commission decided in principle that regulated telecommunications companies should use GAAP accounting. 47 C.F.R. § 32.16. Revision of the USOA to Accommodate Generally Accepted Accounting Principles, CC Docket No. 84-469, 50 Fed. Reg. 48408 (Nov. 25, 1985). The Commission then adopted a policy in USOA Revision, supra, note 10, that regulated companies shall conform with GAAP unless the Commission makes an exception upon finding that GAAP is inconsistent with its regulatory objectives. Since that time, there have been continuing controversies over the propriety of using GAAP in specific circumstances. See, e.g., Pension Accounting, 2 FCC Rcd 6675, 64 Rad. Reg.2d (P&F) 223 (1987) (FCC rejected carriers' petition opposing incorporation of Statement of Financial Accounting Standards No. 87, Accounting for Pensions, into USOA). See also, Uniform Accounting for Postretirement Benefits Other Than Pensions, Responsible Accounting Officer Letter 20 (Com. Car. Bur., May 4, 1992).

B. The Treatment of a Number of Accounts Should be Changed

Falcon strongly urges the Commission to make specific changes to conform the USOA as closely as possible to the stated goals of this proceeding and to the GAAP accounting now practiced by Falcon and the other cable operators. This list is not exhaustive.

§76.1104(b), Regulated accounts: The instructions imply that cable operators must subdivide assets and expenses associated with nonregulated activities into subsidiary records. The Commission should clarify that subsidiary records, or sub-accounts, are necessary only for regulated activities.

§76.1110(b), Nonregulated activities: There does not seem to be any reason to require a "separate set of books" for nonregulated activity. This would be the fourth set of books: financial, tax, regulated cable activity (including nonregulated activity jointly using the plant), and nonregulated activity. Cable operators should have the flexibility to account for both regulated and nonregulated activity on their Part 76 books if they choose. This will not engender any confusion.

§76.1116 & .1118, Accounts receivable allowance: The Commission proposes that Accounts Receivable Allowances (i.e., bad debt allowances) be maintained as contra-revenue accounts rather than expense accounts. This treatment is not consistent with GAAP or with SEC requirements for public companies. Absent a compelling reason, not stated here, these accounts should conform with GAAP.

§76.1122, Inventories: This instruction would appear to require the maintenance of inventory balances on all sets of books even where the inventory is negligible. There should at least be a de minimis level below which the balances would not have to be maintained.

§76.1126, Investments: The requirements of this section appear not to take into account the provisions of Financial Accounting Standard ("FAS") No. 115. FAS 115 addresses the accounting and reporting for certain investments in debt and equity securities and expands the use of fair value accounting for those securities. Fair value is the amount at which a financial instrument could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale. If a quoted market price is available for an instrument, the fair value to be used in applying this statement is the product of the number of trading units of the instrument times its market price. The FAS states that unrealized holding gains and losses for trading securities must be included in earnings. Unrealized holding gains and losses for available-for-sale securities (including those classified as current assets) must be excluded from earnings and reported as a net amount in a separate component of shareholders' equity until realized. The proposed USOA, on the other hand, prescribes that declines in the value of investments shall be written down for declines in value. No mention is made of increases in value.

§76.1133. Instructions for cable services plant accounts: This represents another glaring example of the impropriety of using traditional telephone plant USOA concepts for cable companies. No telephone company has ever acquired the assets of another telephone company at fair market value in an unregulated environment. In fact, it is very rare for a telephone company to change hands at all.[12] Cable companies, on the other hand, have regularly changed hands, as the Commission knows, at much greater than depreciated plant value. Thus, original cost has no relevance to the cable industry as it developed before rate regulation. The Commission cannot and should not try for regulatory purposes to treat transactions as though they had never occurred. It should begin its regulation of the cable industry by taking the industry as it finds it.

Subsection (a) indicates that the cable operator must determine original cost and allocate the rest of the asset value more or less arbitrarily to "goodwill." This type of accounting for plant is not only unworkable at this juncture of the history of the cable industry, it is not even consistent with GAAP.[13]

Under GAAP costs are assigned to an acquired asset based on

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[12] GTE's acquisition of Contel is one of the very few transactions involving large telephone companies. Contel Corp., Acquisition by GTE, 6 FCC Rcd 1003 (1991).

[13] Determining original cost imposes yet another burden on cable operators. If the current operator acquired the system, it probably does not have information about the original cost. It will have to hire appraisers, alter its records and accounting systems and, if it is a public company, adjust its SEC and other financial reports.

the amount paid for that asset. When a group of assets are acquired at the same time, and a unit of cost is not determinable, an appraisal may be required to determine the value, or cost, of the various assets purchased in order to allocate cost to the assets acquired. Under GAAP the cost to a buyer three or four transactions ago is not relevant in determining the cost to the most recent buyer. To attribute to goodwill the difference between the original cost of the very first owner and the amount paid by the current buyer is inconsistent with all methods of recording purchases under GAAP. It is also inconsistent with the practices of those MSOs that are not doing cost-of-service showings and, therefore, not using the USOA accounts. It should also be noted that the USOA gives no guidance on treating a decline in value between the original cost and the cost of the first buyer, or between the cost of the third and fourth buyer. Would there be a reduction in some account called "negative goodwill"?

§76.1136, Cable service plant adjustment: Subsection (b) provides for debiting an income account for purposes of amortizing goodwill. Falcon believes that, to be consistent with GAAP, the debit should be to an expense account. Subsection (b)(2) implies that the goodwill account, rather than a contra-asset account, should be credited directly. This treatment obscures the detail currently available in Falcon's accounting records and is not consistent with GAAP or SEC requirements, which do not permit accumulated depreciation to be netted against

asset cost within the same account.

§76.1165 - .1168, Income taxes: These provisions require a dual calculation of income taxes on regulated and unregulated activities. Here is another example of divergence from financial accounting to no apparent regulatory purpose. It is extremely difficult even to perform more than one tax calculation because of the nature of the IRS tax tables. The Commission should offer clearer justification for the requirements of these sections before imposing yet another significant burden on cable operators.

§76.1189, Instructions for revenue accounts: The Commission apparently requires that bad debts - uncollectible revenue - be netted against revenue within this category. GAAP and the SEC require that public companies break out bad debt and show it separately. Falcon recommends that the Commission conform its rules with SEC rules absent a clear reason for disparate treatment.

§76.1197, Instructions for expense accounts: Overall, the organization and structure of the accounts will make it quite difficult to obtain a true cash-flow number for business purposes. For example, the general and administrative ("G&A") account, Section 76.1230, includes investor relations and external relations. There is nothing of an "operating" nature in these activities. These activities are in a separate "External relations" account, Section 32.6722, for telephone companies. The Commission may have believed that it was making things easier

for cable operators by folding these types of activities into G&A, but it is actually misleading anyone who tries to perform a cash-flow analysis based on regulated accounting.

The Commission must also be aware that cable operators have many fewer supervisory and staff employees than regulated utilities, and those employees tend to perform multiple functions. The organization of the expense accounts may implicitly require operators to have their employees allocate their time, another unnecessary burden. For example, Falcon's office managers' salaries are currently included in G&A as "supervisor salaries." Based on the Commission's proposal, if the office manager spends time training a customer service representative in his or her office, a portion of the time would have to be tracked and allocated to the customer service account, Section 76.1228, as well as G&A, Section 76.1240. Falcon fails to see the purpose of this burdensome requirement.

IV. CONCLUSION

Falcon submits that the Commission has not established a rational predicate for requiring a USOA in conjunction with cost-of-service regulation. Financial accounting according to Generally Accepted Accounting Principles is perfectly adequate to enable the Commission to execute its Congressional mandate to ensure reasonable rates for basic services. If the Commission concludes that a USOA is required, then it should conform that USOA much more closely with GAAP and recognize the inherent differences between the cable industry and the telephone

industry. There is simply no justification for imposing on cable operators the significant expense of maintaining another set of books, records and accounting procedures.

Respectfully submitted,

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